THE EFFECTS OF REGULATORY COMPLANCE ON FINANCIAL PERFORMANCE OF DEPOSIT TAKING SACCOS, A CASE STUDY OF SOUTH RIFT REGION

BY

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A RESEARCH PROJECT SUBMITTED IN PARTIAL

FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINSTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI.

OCTOBER, 2013

DECLARATION

This project is my original work and has not been presented for award of a degree in any other university.

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DEDICATION

To my parents Mr and Mrs William Chumo who have always been a source of inspiration, joy and support in my pursuit for better life.

To my beloved husband Mr Bernard Sonoiya and children Chepchumba, Kipkemei and Kipngetich for supporting and encouraging me while undertaking this study.

ACKNOWLEDGMENT

I thank the almighty God for seeing me through this project.

In a special way I would like to thank my supervisor Mr James M.Ng'anga for his contribution and review of my work, I was really encouraged by his comments, supervision and counsel.

I would also like to thank the SACCOs that responded to my questionnaire by providing me with insightful information for this project success.

Finally I thank my entire family for the encouragement and support during the entire period of my study.

May almighty God bless you all.

ABSTRACT

The SACCO sector is considered both economically and socially important, sectoral report indicates that nearly 5% of savings and Credit Cooperative Societies (SACCOs) collapse every year and registered members withdraw their membership annually. The deteriorating trend is common in most of the societies despite government's financial regulations being in operation since 2004. The objective of this study was to assess the effect of regulatory compliance on financial performance for the deposit taking SACCOs in South Rift Region and extent of compliance of the regulations.

The study used descriptive research design to investigate the relationship between regulation and financial performance. The study was conducted in the twenty eight deposit taking SACCOs in the south rift region. Data was collected using the structured questionnaires and secondary data. Data was analysed using a statistical software (SPSS) version 20. In addition the relationship was analysed using the regression equation modelled around all the multiple variables that affect performance.

Following the study it was possible to conclude that, most SACCOs have complied with the financial provisions of the regulatory requirements. The main compliance noted where separation of the member shares from the share capital, liquidity management systems and enhanced credit policies developed in most SACCOs. The SACCOs were also within the investment thresholds of the regulatory requirements. All the SACCOs complied with the financial reporting requirements.

The study parameters and the variables evaluated to establish and relationship between financial performance and regulatory provisions concluded as follows, Governance had not impacted greatly to the financial performance; this is attributed to the resistance of change in the governance structure. The reporting requirements and prudential requirements had a good causal effect on profitability and financial performance. Compliance of the above provision enabled the SACCOs to address performance issues on time. Most SACCOs are facing the following challenges as they implement and comply with the regulatory provisions. Lack of adequate management information systems, human capital gaps, weak governance structures and high cost of compliance.

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LIST OF ABBREVIATION

CEO	-	Chief Executive Officer
FOSA	-	Front Office Saving Activity
GOK	-	Government of Kenya
ICA	-	International Cooperative Alliance
ICPAK	-	Institute of Certified Public Accountants of Kenya
IRA	-	Insurance Regulatory Authority
SACCOs	-	Saving and Credit Co-operative Societies
SASRA	-	SACCO Societies Regulatory Authority

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The Co-operatives anchor on a well established Co-operative philosophy based on seven principles formulated by the International Co-operative Alliance which include: voluntary and open membership, democratic member control, member economic participation, autonomy and independence, education, training and information, cooperation among co-operatives and finally concerned for the community .

Prudent financial management is a requirement for effective and efficient performance of any organization and, therefore, Savings and Credit Co-operative Societies (SACCOs) are no exception. The total assets of the SACCO subsector stands at over 200 Billion, the growth is mainly member deposit and share capital. The development within the subsector is therefore guided by the medium-term objectives of the financial sector reform and development strategy embedded in the economic development blueprint, Vision 2030. The financial sector reforms objectives are focused on access to quality financial services in a convenient and cost effective way.

1.1.1 Regulatory Framework of the SACCOs in Kenya

In legal and economic literature, there is no fixed definition of the term ‘regulation’. In order to define the subject, regulation will be taken to mean the employment of legal instruments for the implementation of social-economic policy objectives. A characteristic of legal instruments is that individuals or organizations can be compelled by Government to comply with prescribed behavior under penalty of sanctions. Regulations are generally made to correct market failures or to address current challenges.

In the recent past Savings and Credit Co-operatives (SACCOs) have witnessed faster growth, the Co-operative movement in Kenya was started by the European farmers in 1908 when they started the first Co-operative called Lumbwa Farmers Co-operative Society for the purpose of marketing their cereals, fruits and dairy products (Kobia 2011). It was not until the mid 1940's that the colonialists agreed to introduce Cooperatives in the colonies as a piece meal programme for the development of Africa. In 1945, Kenya enacted the Co-operative Ordinance which was followed by the creation of a department under the Registrar of Cooperatives in 1946, whose objectives were to farm and to promote farm products (Kibanga 2001).

The performance of the SACCOs made the Government to take specific measures to improve their effectiveness and efficiency. This was done through, the Co-operative

Societies Act of 1966 Cap 490, the Co-operative Rules of 1969 which gave the Commissioner for cooperative development wider powers to prevent misappropriation

and misuse of funds and also empowered overall efficiency of the co-operative movement. In addition, the second National Development Plan of 1970 – 1974 and more specifically the Co-operative development policy for Kenya under the session paper No. 8 of (1970) and the introduction in 1998 of the Co-operative Act No. 6 of 1997 to govern the operations of the Co-operatives under a liberalized economy.

The liberalization of the Co-operatives led to many of them misusing the powers conjured upon them and this led to the split and collapse of very many Co-operative Societies. The Government realized the need to stop this trend and came up with an Act of parliament to amend the Co-operative and Societies Act of 1997. The rapid growth of SACCOs has come with increased challenges which could not be adequately addressed within the provisions of the Cooperatives Societies Act (CSA) CAP 490, in spite of numerous amendments. In response to this challenge, the Ministry of Cooperative Development and Marketing recognized the need for a specific legislation. Section 91A (1) of Cooperative Societies Act 1997 provided that;

"The Minister shall in consultation with the apex society constitute by notice in the Gazette a body to regulate the operations of savings and credit co-operatives"

In this regard, the Sacco Societies Act (SSA) was enacted and assented to in 2008 providing for the licensing, supervision and regulation of Sacco Societies. The Act also provided for the establishment of the Sacco Societies Regulatory Authority (SASRA) with the mandate to enforce the new legal and regulatory framework. In addition to prudential regulation, the Act also establishes the Deposit Guarantee Fund (DGF) which shall provide protection to members' deposits up to Ksh.100, 000 per member.

1.1.2 Regulation and Performance of SACCOs in Kenya

Performance can be evaluated based on the financial and non financial measures. Guest et al (2003) define performance as outcome, end results and achievement (Negative or positive) arising out of organizational activities. Guest et al (2003) argued that it is then essential to measure strategic practices in terms of outcome. Guest et al (2003) advocates for the adoption of stakeholder's perspective which would ensure that all stakeholders are taken into account when defining the outcomes.

The need to adopt a stakeholder approach meant that multiple measures of performance would be a better approach. This supports the point as anchored on the popularity of the balance score card (BSC) a performance management tool that enables a company to translate its vision and strategy into a tangible set of performance measures. The balance score card provides an organization with an overall performance perspective by integrating financial measures and other key performance indicators (Non Financial). These are the customer perspectives, internal business processes and organizational growth, learning and innovation.

The need for regulatory and supervisory policy in the cooperative sector stems broadly from the same sources as the financial sector. The improvement of financial performance in a regulated environment is of critical importance to the cooperative deposit taking institutions. Performance in this regard may relate to issues of profitability, strength or soundness, efficiency and credit quality. Regulatory frameworks are therefore addressing the direct or indirect costs associated with the realization of performance indicators.

Cooperatives are vital to the economic recovery and have been instrumental in the generation of wealth and employment creation. A significant number of Kenyans, approximately 63 per cent, draw their livelihoods, either directly or indirectly, from cooperative based enterprises. It is estimated that this sector contributes close to 20% of the G.D.P. However, in the recent past, cooperative movement in Kenya has come under very strong attack from many quarters both within and outside the movement as a result of the deteriorating trend in financial performance.

The main issue at stake and which underlies all these attacks are the outcries that cooperatives are grossly mismanaged which has resulted to low financial performance. Therefore, to stimulate the development of this sector, appropriate laws, regulations and supervision framework needed to be put in place. The government through the Ministry of Cooperative Development &Marketing (MoCD&M) came up with policies which were meant to provide minimum operational regulations and prudential standards required in the sector. These policies were meant to streamline; accounting processes, budgets and budgetary control systems, procedures in procurement and disposal of assets, investment policy and external borrowing policy. The movement continues to miss opportunity after opportunity and needs to refocus and reassess its capacity not just to mobilize financial resources, but also to manage them well for faster economic growth of the nation and the welfare of its members.

Despite government's financial regulations that were meant to provide minimum operational regulations and prudential standards having been in place since 2004, most of the SACCOs have been riddled with financial scandals and management problems which have affected their financial performances. Following the regulatory measures introduced, FOSAs have been able to achieve the following since the inception of the prudential guidelines. Uniform chart of accounts adopted by all Deposit Taking SACCOs, Direct up-loading of periodic returns into the Authority's website, Upgrading management information systems of various SACCOs to meet regulatory requirements, Increased adoption of mobile financial services by SACCOs with many entering into partnership with mobile service providers to provide financial services through the mobile phone platform, Increased adoption of Agency Banking through partnership with commercial banks the sector.(SASRA Annual Report 2011)

Deposit taking SACCOs have realign their operational policies and systems to the regulatory standards to underscore the business risks attendant to them this been the credit, operational, liquidity, market and legal. Following the introduction of the regulatory framework SACCOs now have data to enable banks and insurance companies to deepen financial access, currently IRA is exploring ways of selling insurance products through SACCOS. The performance trend for the FOSA is illustrated under **Appendix 2 and 3** which highlight on the financial position and the balance sheet analysis showing a progressive growth. (SASRA Annual Report 2011)

1.1.3 South Rift Region

The South Rift comprises of the following counties Narok, Nakuru, Bomet, Kericho, Kajiado and Baringo. The deposit taking SACCOs in the region are twenty eight the table below show the distribution of the SACCOs in the Region.

Table 1: Distribution of Deposit Taking SACCOs

S/NO	County	Deposit Taking SACCOs
1	Kericho	7
2	Narok	2
3	Bomet	10
4	Nakuru	5
5	Kajiado	2
6	Baringo	2

Source: SASRA Supervision Report 2011, Distribution of Deposit Taking SACCOSs.

The south rift is mainly agricultural region, the highlands provide adequate rainfall for farming and agricultural activities which are the main economic base of the region. The region has most of the SACCOs formed from the Agricultural sector. The main economic activities are tea farming and horticulture, the region also has tourism in the

Narok, Baringo and Nakuru County. The area physical geographical topology is mainly mountains, lakes, forest and plains.

1.2 Research Problem

The Government restructured the legal framework to give complete autonomy to the Cooperative sector, this was to allow them fit in the competitive financial market. Area of regulation and financial performance has received attention and studies such as Temple et al (2005) suggested that strict regulation hinders the adoption of existing technologies through reduced competitive pressure and spillovers and hence negativity affecting performance. On the contrary Berr (2008) argues that, while there is much discussion of negative impact of regulation, some regulations can have a positive impact on productivity.

Lack of financial regulation and supervision has been the biggest weakness in the Kenyan SACCO, this is because of the absence of standard legislation and monitoring mechanisms. The Government has enacted legislations by developing the SACCO Societies Act, No. 14 of 2008 and also the SACCO Societies (deposit – taking SACCO business) regulations 2010, is divided into eight (8) parts namely, the Preliminary, the SACCO Societies Regulatory Authority, Licensing of SACCO Societies, Governance of SACCO Societies, Regulation and Supervision of SACCO Societies, the deposit guarantee fund, miscellaneous and a schedule of how to conduct of the affairs of the board (Kenya gazette No. 39 dated 18th June, 2010).The challenge for the deposit taking SACCOs is to implement this regulatory compliance requirement and remain competitive in the financial market.

Ngaira (2011) concluded that the SASRA prudential regulations have impacted on SACCOs performance in terms of outreach, sustainability and performance. and concluded on operational and financial challenges in implementing the regulations resulting from cost of loans and speed of processing loans the other challenge noted was the liquidity provisions and the control of investment avenues that affected the SACCOs operational capacity and ability to competitively remunerate its employees.

Mbui (2010) in his study concluded that STIMA SACCO had the following challenges as a result of the new regulatory environment, capital adequacy challenges, high cost of compliance, human resources capacity constraints, stringent liquidity requirements, tough disclosure requirements and balancing compliance with political interests.

SACCOs providing front office services are essentially banks and should be held to the strictest banking standards with regards to asset and liability management, credit and operational risk (Business Daily 2012).

Gamba and Kombo (2008) analyzed the evolution, growth and decline of the cooperative sector and argued that on the whole cooperatives have been unable to provide farmers with credit and farm inputs for financing production.

The study on regulation and financial performance will bridge the knowledge gaps that exist by establishing effects of regulatory compliance on financial performance of the deposit taking SACCOs. The main aim is to ensure that the SACCOs are able to efficiently and effectively comply in order to achieve the long term objective of the Vision 2030 of improving accesses and deepening of financial services and products.

1.3 Research Objectives

The broad objective of this research is to assess the effects of regulatory compliance on financial performance of deposit taking SACCOs in South Rift Region.

The specific objective will be:

1. To establish the extent to which Sacco societies in South Rift have implemented these Government's financial regulations.
2. To analyze the relationship between the extents to which these SACCOs have implemented the financial regulations and their level of financial performance.

1.4 Value of the study

The results of the research are meant to benefit the following groups:-

1. **Government Regulatory Agencies**

   Government regulatory agencies such as Capital Market Authority, Insurance Regulatory Authority and the Central Bank of Kenya will benefit from the information that relate to the financial sector in terms of regulations. This will help the regulators in setting the current regulatory compliance needs and the long-term changes.

2. **Academic and Researchers**

   The sector (SACCO Industry) has less literature to review and thus the study will provide the information on a wider scope. The findings of the research are important since it will contribute to the existing academic literature and stimulate further research in the field of regulation, compliance and supervision of the financial sector.

3. **Government**

   This Research information will help the Government when developing economic policies. Regulation is about citizen protection and citizen welfare and thus the regulations will be able to assist the Government in knowing the effectiveness of the regulator in the financial sector by comparing with other regulators.

4. **Members of the Society and Customers**

   These are the shareholders and the society, the research findings will help them to know whether their money is used for the purposes they have invested for.

5. **Saccos Societies Regulatory Authority (SASRA)**

   Being the regulator the study will help in addressing the challenges facing the SACCOS for effective regulatory and compliance levels to be optimal. The regulator will get information on how to improve the regulatory environment and the benefit of the regulations. The study will highlight on the current and future regulatory demand

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter explains the components and theories that comprise regulations, financial and operational excellences in the SACCO Industry. The chapter will review the literature related to the area of study and gaps to be filled. The literature review will look at previous research studies carried out in the journals, seminar papers, conference reports, Government legislations and sector reports.

2.2 Theoretical literature Review

2.2.1 The need for Financial Regulation

This section provides an overview of the literature relating to regulation and the need for regulations. Theories of regulations are set upon the following hypothesis: why regulation emerges, who are the actors and patterns of interaction among the regulatory actors.

The economic literature distinguishes between **positive and normative economic theories of regulation**. The positive variant aims to provide economic explanations of regulation and to provide an effect-analysis of regulation. The normative variant investigates which type of regulation is the most efficient or optimal. The latter variant is called normative because there is usually an implicit assumption that efficient regulation would also be desirable.

Armstrong (2005) looked at the development and techniques of regulations as having long been the subject of academic research. He examined two basic schools of thought that have emerged on regulatory policy, namely, positive theories of regulation and normative theories of regulation. Positive theories of regulation examine why regulation occurs. These theories of regulation include theories of market power, stakeholders interest in regulation, and the theories of Government opportunism that describe why restrictions on Government discretion may be necessary for the sector to provide efficient services for customer. Generally, the conclusions of these theories are that regulations occur because; the Government is interested in overcoming information asymmetries with the operator and in aligning the operator's interest with the Government's interest, customers desire protection from market power when competition is ineffective, operators desire protection from rivals, or operators desire protection from Government opportunism.

Hertog (2007) supported Armstrong's argument as he agreed with the public interest theory which suggested that Government regulations is a response to public demands for Government to rectify situations of market failure through imperfect competition, market disequilibria, information asymmetry or markets that are undesirable for social reasons. This theory assumes that; the market outcome represents a "failure" of some sort, and the market is not capable of fixing the problem itself, the Government is capable of fixing that failure so that the optimal efficient outcome will be achieved, and that the benefits of doing so will outweigh the additional costs created by the intervention.

Hahn (2006) noted that financial regulations happen in response to market failure, with regulation correcting the inefficiency while.

Dale (1997) argued that the theoretical underpinning for public intervention in economic matters is traditionally based on the need to correct market imperfections and unfair distribution of resources.

Barth *et.* a*l.*, (2002) raised many arguments in favor of Government intervention in the financial sector. They argued that the existence of monopoly power externalities and information asymmetries create beneficial role for Government interventions to offset market failures and enhance social welfare. They also argued that regulation helps to redistribute wealth away from the institutions to stakeholders even when there are no market failures.

Dawatripartwe *et. al.,* (1994) who thought that there is a high existence of information asymmetry that normally occurs in the financial institutions, also stressed the need for io'regulation. They argued that whereas the financial managers may be privy to certain important financial information, they may not want to share this information with the rest of the stakeholders.

Goodhart *et. al.,* (1992) in their study of financial markets in the USA concluded that financial regulation is indeed a public good as it serves three objectives, namely; it creates stability, transparency and investor protection.

Noia *et. al.,* (1998) concurred with the findings of Goodhart by concluding that the general need for public financial intervention is anchored in the pursuit for stability, equity in the distribution of resources and the efficient and effective use of those resources.

2.3 Elements of SACCO Regulatory Framework in Kenya

This section reviews the regulatory framework of the SACCOs in Kenya, Government regulate industries with the aim of protecting consumers. This is why Government regulate public utilities which may use monopoly positions to exploit consumers. SACCOs need to comply with the following wide range of regulatory provisions in their day-to-day operations. These include but not limited to:

2.3.1 Government regulation on corporate governance

Governance rules, this is the manner in which organizations are controlled and managed. At a minimum, the Board of Directors (elected at the Annual General Meeting) has to establish an audit committee and credit committee. It will also be their responsibility to establish appropriate policies on credit, investment, human resource, savings, liquidity, information preservation, dividend, and risk management.

A major change on governance is that directors and senior management are subject to vetting (fit and proper test) by SASRA. The separation of the responsibilities of the Board and the management has been clearly outlined in the Regulations to ensure transparency and accountability in the running of the SACCO.

2.3.2 Government's regulation on Reporting of Financial Performance

Business performance practice requires that there must be good accounting systems within any enterprise for real financial performance to be realized. It points out the problems faced or likely to be faced by the enterprise. This therefore, calls for proper book-keeping practices by the SACCOs in order to conform to the international accounting standards.

Wambui (1993) on the regulation of auditors' reports in investment decisions revealed that most of the companies whose books of accounts are audited annually tend to perform better that those who don't. The Cooperative Society Act stipulates that every cooperative society must cause its books of accounts to be audited every financial year and the accounts be presented to the shareholders four months after the end of the financial year. It is required that the books of accounts be approved by the Commissioner for Cooperative Development (CCD) before presentation to the shareholders. Where accounts are not audited and presented within four months, committee members will automatically lose their positions at the next general meeting unless the CCD is satisfied with the reasons for failure.

Reporting requirements**,** SACCOs are subject to adhering to monthly returns (capital adequacy, liquidity, and deposits), quarterly returns (risk classification of assets and loan loss provisioning, investment returns, financial performance) and annual returns (audited financial statements) reporting requirements to SASRA.

2.3.3 Government's regulation on investment policy

An investment is the outlay of a sum of money in the expectation of a future return which more than compensates for the original outlay plus a premium to cover inflation, interest foregone and risk. The process of investment appraisal is designed to ensure that the right amount of money is invested in the right projects at the right time. Pandey (1996) asserts that too little investment, in the long run is more dangerous than too much.

Too little investment leads to inefficiency and certain slow stagnation. Too much involves unacceptable levels of risk, but at least has the possibility of success. In the short term the converse is true- too little is the safer option. These conflicting needs have to be balanced in order to obtain sustainable financial performance, hence, calling for proper regulatory and supervisory mechanisms. It's one very significant aspect is the task of measuring the prospective profitability of new investments. Any investment decision as source of raising funds for the firm must consider the interests of the shareholders.

As per SASRA Regulatory provision, investment in non earning asset should not exceed 10% of the total assets in which land and buildings should not exceed 5% of the total assets .The Board of Directors are responsible for the formulation of the investment policy which shall be frequently updated. Financial investment should not exceed 40% of core capital or 5% of total deposits

2.3.4 Government's regulation on prudential financial management

Pandey (1996) noted that because of the importance of the financial decisions to a firm, it is important to set up a sound and efficient organization for the finance functions. Financial decisions are crucial for the survival of the firm since the growth and development of the firm are directly influenced by the financial policies that the firm adopts. A financing decision is meant to either retain the profits earned by the business or distribute them among the shareholders via dividends.

SASRA provisions on financial management are covered by the prudential standards. The Prudential standards under the provisions of the Act and Regulations include clear standards regarding, among others, capital adequacy, liquidity policy, the extent of external borrowing, asset categorization and provisioning, maximum loan size, and insider lending.

Capital Adequacy Requirements ,SACCOs are required to meet the following minimum ratios for capital adequacy requirements, Core capital of not less than Kshs 10million, Core capital of not less than 10% of total assets, Institutional capital of not less than 8% of total capital and Core capital of not less than 8% of total deposits.

Liquidity requirements 15% of the savings deposits and short term liabilities shall be maintained in liquid assets. Sacco Societies required to put in place contingency plan to handle liquidity that includes procedures for making up liquidity shortfalls in emergency situations. There is weekly monitoring of liquidity and requires submission of a monthly statement of liquidity return to the Authority

Credit Management, It is mandatory to have a loaning policy specifically detailing loan concentration limit, terms and condition of insider lending. The borrower to be provided with quarterly statement of each outstanding credit facility .A Sacco Society shall seek prior approval to introduce any new loan product. External borrowing: the Sacco shall not borrow more than 25% of its total capital and shall charge interest

2.3.5 Government Regulation on General Operations

The SASRA regulations have general guidelines on the operations of the SACCOs as outlined below: - Enforcement actions**,** SASRA have the authority to inspect the premises and the records of a SACCO and to prescribe enforcement actions in case of deficiencies including the appointment of a statutory manager. Non-compliance with legal requirements carries clearly specified penalties and includes removal from office of directors and other responsible officers.

Deposit insurance scheme, once licensed, member deposits will be protected in the event of collapse of a SACCO.SASRA will in the future set up a Deposit Guarantee Fund and SACCOs will be expected to contribute to this. Coverage to a limit of shs.100, 000. The Fund shall vest on a Board of Trustees. Four members of which are nominated by the SACCOs.

Branch approval .Opening, closing, and relocating branches and other places of business require prior approval by SASRA.

Services to members only SACCOs shall continue to operate according to co-operative principles and deal with members only. Serving members only is the main reason why interest and other income earned from loans to members is exempt from income tax.

2.4 Financial Performance Measures

Financial performance measure is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. Performance measures are quantitative and qualitative, they provide a tool for organisations to manage progress towards achieving predetermined goals.

Performance measurement is a process of assessing the progress made (Actual) towards achieving the predetermined performance goals (baseline). Measurement is managed using outputs measures and outcome measures.

Traditionally financially based performance measurement approaches have a number of serious setbacks (Kaplan & Norton 1992).These include the elements of outcomes focus, established financial indicators such as profitability, turnover, and asset base. They only alert when things have gone wrong and the effect is felt in the balance sheet. Such indicators and measures don't provide us with the indication of when things are nit going on well. This indictors are lagging and not leading indicators-they don't provide warning signals.

There are many different measures of financial performance, but all measure should be taken with aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used as well as total sales units. The most common financial measures for performance are Return on Assets (ROA) , Returns on investments(ROI) and Return on Equity (ROE).

2.5 Non Financial performance Measures

The concept was created out of the observation that the traditional financial performance measurements systems are based on financial performance indicators. This would be inadequate to fast track the organisation into the future. Non financial indicators are clear indictors of how the financial performance is likely to be. The balance scorecard is based on the simple premise that we must understand and measure the true drivers of financial success (Kaplan and Norton 2004). The balanced scorecard identifies three broad areas called perspective of the perspective corporate body that must be examined that in turn deliver the final dimension of the balance scorecard-Financial success. These include learning and growth perspective, Internal business processes perspective and customer perspective.

Attainment of financial objectives-growth, lower cost and above all increases in the shareholder value is driven by the other dimensions or perspectives in the organisation. It is fully premised on learning and growth .skills culture ,leaders and management information that are aligned to the organisation strategy which will create efficient and effective product delivery, customer relationship, innovation, regulatory and environmental processes in turn make sure that the organisation offerings meet and exceed the needs of the customers.

The components of the organisation offering to the customers are shown in the customer perspective. Satisfied customers and efficient business process combine to produce growth, lower cost and better us of the organisation capital and results being increase of the shareholder value.

2.6 Empirical Literature

Regulation of the SACCO industry is a relatively new area having a history of the last five year since the year 2009.Highligted below are some of the researches, sector reports that have been done in the area of regulation and SACCO Management.

Wamalwa (2012) studied the impact of regulation on SACCO performance and concluded that the SACCO performance has greatly improved following the compliance of the Governance rule, Prudential Regulations and the Reporting requirements.

Omonyo (2003) studied investment practices among pension firms in Kenya and notes that there is need for regulations to ensure that managers execute their fiduciary role to the great benefit to pensioners. They do so by carefully and professionally applying funds under their charge to the optimal assets classes. Where there is danger that this duty could be overlooked leading to moral hazards and hence the need for official intervention to protect shareholders and public interests. Regulation are developed for a given industry and while they seek to achieve a common good they at times in themselves become a hindrance to investment decisions and thus overall performance of the institutions been regulated.

Mbogo (2010),the cost of running deposit taking SACCO is set to go up significantly with these new set of regulations in effect threatening the low interest regime that has for decades given the cooperative movement an edge over the commercial banks in the lending market. The regulations covering 220 deposit taking SACCOs, also known as FOSA with an estimated membership of five million and assets worth 196 Billion ,demands that societies converting from non deposit taking SACCOs invest in new banking halls and install sophisticated security equipment ,including armed security personnel .This will definitely increase the operational costs of the SACCOs.

Ngaira (2011) the SASRA prudential regulations have impacted on SACCOs performance in terms of outreach, sustainability and performance. SACCOs reported improvements in membership, loan portfolio and loan cycle reduced and general efficiency and concluded on operational and financial challenges in implementing the regulations resulting from cost of loans and speed of processing loans the other challenge noted was the liquidity provisions and the control of investment avenues that affected the SACCOs operational capacity and ability to competitively

Muruiki et al (2013) on the overall degree of improvement of corporate governance Majority (41.7%) of the respondents opined that SASRA provisions had improved corporate governance to a little extent while 8.3% of the respondents opined that it had improved corporate governance to a great extent. Some respondents (33%) felt there was no change on corporate governance while 16.7% indicated it was moderate.

On areas SASRA financial provisions had failed to improve corporate governance, the respondents indicated that insider lending was not addressing it fully. High fee on SASRA levy interfering with members' funds and the mandate between management and the board were also identified as areas not improved by the provisions.

Mbui (2010) in his study concluded that STIMA SACCO had the following challenges as a result of the new regulatory environment, capital adequacy challenges, high cost of compliance, human resources capacity constraints, stringent liquidity requirements, tough disclosure requirements and balancing compliance with political interests.

Ademba (2006) in his report on the major challenges facing the regulators outlined the following to be the major challenges: low capacity of regulators due to limited financial resources and limited skilled and competent manpower who fully understand SACCO operations. Low adoption of technology from SACCOs and regulators, different growth phases of SACCOs, some easily meet the prudential standards while others struggle, legal tussles between the regulators and SACCOs, Change resistance and compile multifunctional institutions which border between a SACCO ,MFI and A bank.

Dempsey *et. al.,* (2002) posited that cooperatives "destroy value" since few cooperatives have changed the way they operate. They said that several financial ratios for cooperatives (revenue growth, return on assets and operating margins) were calculated which indicated weak financial performance in the cooperative sector. Another financial performance measure, "value created" was also analyzed; it was based on "return on invested capital" this also reported a low financial performance in cooperative societies. In their conclusion, they realized that firms which were regulated performed better than cooperatives which were left unregulated.

Challenges of implementing the new regulatory framework differ significantly because of the size and diversity of the SACCO society. (SASRA SACCO

Supervision Report 2010 and 2011), while majority of the Sacco societies satisfy the minimum licensing requirements namely capital adequacy, physical infrastructure and internal controls there are notable challenges for the effective compliance with the Act and Regulations. These include:-

Low understanding of the Act and Regulations, Governance structure: The historical practice where the management committee (now called Board of directors) comprising of elected officers are heavily involved in the operational affairs of the Sacco to the exclusion of the technical staff is deeply entrenched limiting the effectiveness of the Act and Regulations in licensed Sacco societies. Technical capacity: The effective implementation of the new legal and regulatory framework requires a new set of skills and knowledge. This requires financial resources and time besides the attitude change amongst the leaders.

2.7 Chapter Summary

The chapter considered the theoretical literature on the need for financial regulation, the current Government regulatory provisions with specific reference to governance investment decisions and prudent financial management. Empirical studies were reviewed to point out the knowledge that already exists and known about the subject of regulations and the effects of regulatory compliance on financial. The findings of the literature review raised the following points.

SACCOs have faced a myriad of challenges in which the new regulatory regime was enacted to solve and address the challenges. The adoption of the regulations remains as a major challenge to the Deposit Taking SACCOs. The literature review pointed out the critical role the SACCO play in the financial sector as outline in the Vision 2030.Studies and controversies on the role of regulations in the sector were considered and the absence of the consensus as to whether less regulation leads to better performance was underscored. It is in this context that the study seeks to explore the effects of regulatory compliance on financial performance of deposit taking SACCOS.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter outlined the methodology, which was used in carrying out the study. Aspects covered included the research design, population, sampling design, data collection methods and data analysis methods. The research used primary and secondary data to achieve the research objectives. The study investigated the effects of regulatory compliance on financial performance.

3.2 RESEARCH DESIGN

The study used the descriptive research design to investigate the relationship between the dependent and independent variables.

Kothari (2004) state that research design is the arrangement of conditions for collecting and analysing data in a manner that is aimed to combine relevance to the research purpose with economy in procedure. Cooper and Schindler (2005) observed that a design is a plan for selecting the sources and the type of information used to answer the research question and a framework for specifying the relationship among the study variables.

Descriptive design was used to enable the study collect comprehensive data on the population under study and thus providing relevant and specific information. The design is suitable because the study deals with the relationship between the variables and development of generalisation that have collective validity.

3.3 POPULATION AND SAMPLING DESIGN

3.3.1 POPULATION

According to Copper and Schindler (2005) population is the total collection of elements about which we wish to make some inference. Mugenda and Mugenda (2003) further define the population as that population which the researchers want to generalise the results of the finding.

The target population for this study was twenty eight (28) deposit taking SACCOs in the South Rift Region. The study used cluster sampling technique to select 4 respondents from each SACCO Society i.e. the executive committee members (Chairman, V/chairman, Secretary and the Treasurer), the supervisory committee members, and senior management, since these are the people who directly and actively deal with the events under study.

3.3.2 SAMPLING DESIGN

Copper and Schindler (2005) defined the sampling process as the process of selecting elements in a population for purposes of drawing conclusion on specific characteristics. The study used all the elements in the population for the study. This is because the number of licensed deposit taking SACCOs in south rift region are twenty eight and all were covered in the study.

3.4 DATA COLLECTION METHOD

The study involved the collection of data using the structured questionnaires, interviews and document analysis. This enabled the researcher collect both the primary and secondary data. The focus of the study was to carry out an intensive study of the regulatory compliance with the questionnaire divided under the following categories. Section one the institutional profile, section two the financial regulatory provisions compliance, section three regulatory provisions and relationship with financial performance.

3.5 DATA ANAYLSIS

Data analysis involves the organisation, summarisation and interpretation of research data using qualitative statistical tools (Kasomo, 2006).

Cooper and Schindler (2005). Data analyses usually involve reducing accumulated data to manageable size developing summaries looking for patterns and applying statistical techniques.

The collected data was analysed using the regression analysis conducted using statistical packages for social sciences (SPSS Version 17).

The financial indictor of performance was profitability. Regulations was measured under the following constructs: Governance Regulations, Reporting Regulations , prudential standards and general operations.

To achieve the objectives of the research the following regression equation was used.

$$Y=a+boX1+b1X2+b2X3+b3x4+e$$

Y= Profitability (Return on Asset)

X1=Governance

X2=Prudential Standards

X3=Reporting Regulations

X4=General Operations

a'=Constant

b0,b1,b2,b3,=Regression Coefficients

e= error term

The financial performance used for the study was ROA (Return on Assets) and the specific regulatory requirements were Profitability, Governance, Prudential Standard, Reporting Regulations and General Operation.

The study applied the F and T significance test to establish the relationship between financial performance and regulatory compliance requirements. The study used the coefficient of determination to establish the strength of the relationship in terms of deviation from the dependent and independent variables. The study also used the inferential statistics (ANOVA) to test how the independent variables (the determinants) affect or determines the financial performance of SACCOs.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

This chapter presents the analysis of data collected. The presentation is done as per the research objectives. A total of 60 questionnaires were administered and the study obtained 51 questionnaires representing 85% response rate.

4.2 Institutional Profile

This section presents the institutional profile mainly the demographical characteristics of the study target. The section will elaborate on the sponsoring entity, Number of years in existences, membership number and capitalization limits

4.2.1: Years of Operation

The study sought information about the years SACCOs have been in operation. Findings are presented below.

Table 4.1: Years in Operation

Years	Frequency	Percent
0-5 Yrs	6	12
5-10 yrs	24	47
>10 yrs	21	41
Total	**51**	**100**

Source: Research Data

From the findings, majority of the respondents (47%) indicated that they have been in operation for 5 – 10 years, 41% for >10 years and 12% for 0-5 years. This indicate that more than 88% of the SACCOs have been in operation for more than 5 years.

4.2.3 Number of Members

The study in this section sought information about the number of membership SACCOs have. Table 4.2 presents number of members.

Table 4.2: Number of Members

	Frequency	Percent
0 - 20,000 members	14	27
20,000 - 80,000 members	27	53
> 100,000 members	10	20
Total	**51**	**100**

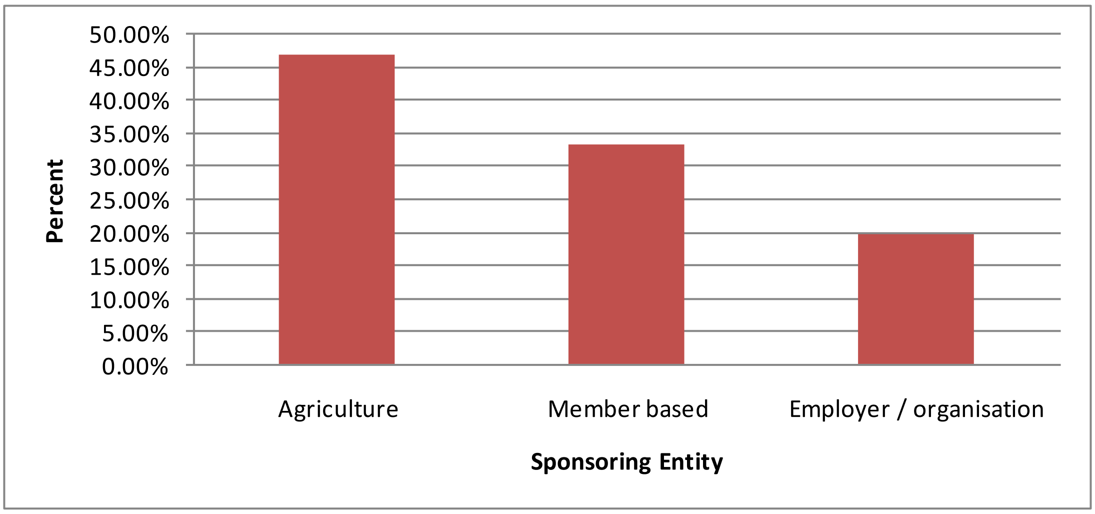
Source: Research Data

From the findings, majority of the respondents (53%) indicated that they have 20,000 – 80,000 members, 27% have 0 – 20,000 members while 20% of the respondents have more than 100,000 members. The results indicate that SACCOs in Kenya have more than 20,000 members.

4.2.4 Sponsoring Entity

The study in this section sought information about the sponsoring entities of SACCOs. Figure 4.1 presents the findings.

Figure 4.1 Sponsoring Entity

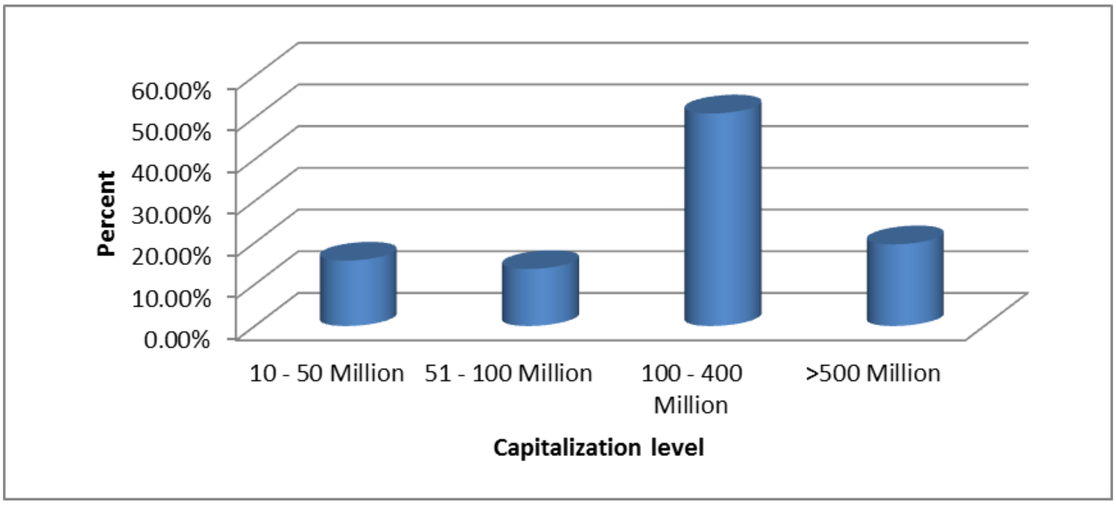


Majority of the respondents (47%) indicate that they are sponsored by agricultural entity, 33% are member based sponsored while 20% are sponsored by employers / organisations. The findings indicate that most of SACCO societies are sponsored by agricultural entity.

4.2.5 Current Capitalization Level

The study in this section sought information about the current capitalization level of SACCOs. Figure 4.2 presents the findings

Figure 4.2: Current Capitalization Level



From the findings, majority of the respondents (51%) indicated that their capitalization level is between 100 – 400 million, 20% more than 500 million, 16% between 10 – 50 million while 14% are between 51 – 100 million. This indicates that majority of SACCOs have capitalization level of more than 100 million.

4.3 Financial regulatory Provision

The study in this section sought information about the financial regulatory provision. The study in this section used a 5-point scale no extent; less extent; neutral; large extent; and very large extent. Findings are presented in a table below using means and standard deviations

Table 4.3: Financial regulatory Provision

	Mean	Std. Deviation
Separation of shares from member deposits	4.57	0.728
Maintaining the 15% Liquidity	4.00	1.039
Putting in place contingency plan to the authority	4.20	0.606
Monitoring of liquidity and submission of a monthly statement of liquidity return to the Authority	4.43	0.575
Not to engaging in prohibited business	4.45	0.832
Not depending on short term external borrowing	4.29	1.026
Developing loaning policy specifically detailing loan concentration limit, terms and condition of insider leading	5.35	6.991
Providing borrowers with quarterly statement of an outstanding credit facility	4.24	0.764
Seeking prior approval to introduce any new loan product	4.31	0.707
External borrowing, the SACCO shall not borrow more than 25% of its total capital and shall charge interest at	4.18	0.842

least 2% higher than the borrowing rate		
Classification of loan in the following categories; performing, watch, substandard, doubtful	4.29	0.807
Financial investment should not exceed 40% of core capital or 5% of total deposits	4.10	0.985
Providing borrowers with quarterly statement of an outstanding credit facility	4.25	0.868
Investment in non-earning asset should not exceed 10% of the total assets in which land and buildings should not exceed 5% of the total assets	4.04	1.148
Auditing and reporting on a monthly, quarterly and annually as per the regulations	4.55	0.901

Source: Research Data

From the findings, majority of the respondents were in agreement on the provision that developing loaning policy specifically detailing loan concentration limit, terms and condition of insider leading. This scored a mean score of 5.35. Separation of shares from member deposits provision scored a mean score of 4.57, auditing and reporting on a monthly, quarterly and annually as per the regulations (4.5), not to engaging in prohibited business (4.45) and monitoring of liquidity and submission of a monthly statement of liquidity return to the Authority (4.43). Maintaining the 15% liquidity provision scored the low mean of 4 after investment in non-earning asset should not exceed 10% of the total assets in which land and buildings should not exceed 5% of the total assets provision scored 4.04.

4.3.1 Challenges faced in Meeting Provisions

The challenges of lack of enough funds, regulation cost, governance issues, Management Information Systems and ICT were highly mentioned by respondentsas the major challenges faced in meeting provisions. Other challenges as mentioned by respondents are: Low understanding of act; staff constrains; information technology challenges; management issues; Data reliability; lack of documented policies; capacity of skills and competency; data integrity issues; reducing the investment for more capital; initial cost of compliance; lack of skills; procure source for information systems; lack of technical knowledge; inappropriate management information systems; low legislation understanding; no policies/procedure; governance structures and lack of technical capacity.

4.3.2 Strategies Used by SACCOs

The major strategies that were indicated by the majority of the respondents are: Training; Enhanced Compliance; Procurement of information and Mobilize funds from members. Other strategies as indicated by respondents are: Lower/subsided cost; enhanced recruitment; compliance seminars; regular upgrading of IT systems; clean data; recruit competent staff; train existing staff; investment in key competency management systems; implement prudential regulations; divestment on a certain scale; piece meal investment; open to more members and employ experts in the field.

4.3.3 Business Opportunities

The business opportunities that have been created by the new regulatory framework are: Increased production; More members; can transact with customers; has created financial discipline; sales; information source to other people and open to other members for training.

4.4 Effects of Regulatory Compliance on Financial Performance

The study in this section sought information about the effects of regulatory compliance on financial performance. Findings are presented in table below using means and standard deviations.

4.4.1 Effect of Regulatory Compliance of Governance on Financial Performance

Table 4.4: Effects of Regulatory Compliance of Governance on Financial Performance

	Mean	Std. Deviation
Governance regulation on the election of the independent board has it improved profitability	3.45	0.901
Have the established committees (Audit, credit and finance committee) improved financial performance	3.41	0.963
Has the directive of directors been subjected to fit and proper test improved performance	3.43	0.900
Separation of board and management. does it have effect on financial performance	3.45	0.986

Source: Research Data

From the findings, majority of the respondents were in agreement that governance regulation on the election of the independent board has not improved profitability and separation of board and management has affected financial performance. They both scored a mean of 3.45. The statement on the directive of directors have been subjected to fit and proper test improved performance scored 3.43 and whether the established committees (Audit, credit and finance committee) has improved financial performance scored 3.41.

4.4.2 Effects of Regulatory Compliance of Reporting Requirement on the Financial Performance

Table 4.5: Effects of Regulatory Compliance of Reporting Requirement on the Financial Performance

	Mean	Std. Deviation
Effects of regulation of reporting requirement of monthly capital adequacy, liquidity, and deposit on financial performance	4.35	0.844
Introduction of regulation reporting of quarterly risk classification of assets and loan provision of loss and investment returns on the profitability of the SACCO	4.51	0.758
Effect of the annual audited accounts on the profitability and financial performance of the SACCOs	4.63	0.720

Source: Research Data

Majority of the respondents were in agreement about the effect of the annual audited accounts on the profitability and financial performance of the SACCOs having scored a mean of 4.63, Introduction of regulation reporting of quarterly risk classification of assets and loan provision of loss and investment returns on the profitability of the SACCO (4.51) and Effects of regulation of reporting requirement of monthly capital adequacy, liquidity, and deposit on financial performance scored 4.35.

4.4.3 Effects of Regulatory Compliance of Prudential Finance Requirement on the Financial Performance

Table 4.6: Effects of Regulatory Compliance of Prudential Finance Requirement on the Financial Performance

	Mean	Std. Deviation
Effects of the capital requirements on the financial performance of the SACCOs	5.69	7.070
Effect of the external borrowing requirement on the financial performance	4.65	0.744
Effect of the asset categorization requirement on the financial performance	4.57	0.640
Effect of the regulatory requirement of insider trading on financial performance	4.65	0.658

Source: Research Data

Majority of the respondents were in agreement about the effect of the capital requirements on the financial performance of the SACCOs which scored a mean score of 5.69, the effects of the regulatory requirement of insider trading on financial performance and external borrowing requirement on the financial performance which scored a mean score of 4.65 and the effect of the asset categorization requirement on the financial performance scored 4.57.

4.4.4 Effects of Regulatory Compliance of General Operation Requirement on the Financial Performance

Table 4.7: Effects of Regulatory Compliance of General Operation Requirement on the Financial Performance

	Mean	Std. Deviation
Effect of general provision of branch opening approval on the financial performance of the SACCOs	4.35	0.716
Effect of enforcement action to inspect the SACCOs on the financial performance	4.41	0.606
Effect of not engaging in prohibited business on the financial performance of the SACCOs	4.29	0.879

Source: Research Data

Majority of the respondents were in agreement on the effect of enforcement action to inspect the SACCOs on the financial performance which scored a mean of 4.41, effect of general provision of branch opening approval on the financial performance of the SACCOs scored 4.35 and effect of not engaging in prohibited business on the financial performance of the SACCOs scored 4.29.

4.4.5 Other Non-Financial gains

Other non-financial gains as indicated by the respondents are: customer satisfaction; participation in financial sector; licensing of SACCOs; social justice; motivated staff and Inspection.

4.5 Analytical Model

4.5.1 Data Summary

This section sought to provide the summary of data that was used. Table 4.1 presents summary of data

	Mean	**Std. Deviation**
Profitability	3.4278	2.5504
GOV	3.4363	0.83493
PRU	4.8873	1.87371
REP	4.4967	0.65785
GENO	4.3529	0.63117

Source: Research Data

From the findings, Profitability had a mean score of 3.4378 with a standard deviation of 2.5504, Governance had a mean score of 3.4363 with a standard deviation of 0.83493, Prudential Standards had a mean score of 4.8873 with a standard deviation of 1.87371, Reporting Regulations had a mean score of 4.4967 with a standard deviation of 0.65785 and General Operations had a mean score of 4.3529 with a standard deviation of 0.63117.

4.5.2 Relationship of the Regulatory Provisions and Financial Performance

Table 4.3 presents Pearson Correlation coefficients

		ROA	**GOV**	**PRU**	**REP**	**GENO**
Pearson Correlation	**ROA**	1	0.103	0.421	0.146	0.477
	GOV	0.103	1	0.115	0.181	0.244
	PRU	0.421	0.115	1	0.234	0.223
	REP	0.146	0.181	0.234	1	0.142
	GENO	0.477	0.244	0.223	0.142	1

Source: Research Data

The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by r. Basically, a Pearson product-moment correlation attempts to draw a line of best fit through the data of two variables, and the Pearson correlation coefficient was conducted to examine the relationship between variables, r, indicates how far away all these data points are to this line of best fit (how well the data points fit this new model/line of best fit).

The Pearson correlation coefficient, r, can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. As cited in Wong & Hiew (2005) the correlation coefficient value (r) range from 0.10 to 0.29 is considered weak, from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong. However, according to Field (2005), correlation coefficient should not go beyond 0.8 to avoid multicollinearity. Since the highest correlation coefficient is 0.477 which is less than 0.8, there is no multicollinearity problem in this study.

As shown in Table 4.3, there is a positive correlation between general operations and return on assets (r = 0.477) while there is a weak positive correlation between return on assets and governance (r = 0.103)

4.5.3 ANOVA

In assessing whether the model could significantly predict the financial performance of the SACCOs in Kenya, the F-statistic from the ANOVA table was used and the results were in table 4

ANOVAa						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	215.371	4	215.371	20.497	.738b
	Residual	511.743	56	6.777		

	Total	727.114	50			
a Dependent Variable: ROA						
b Predictors: (Constant), GENO, REP, GOV, PRU						

Source: Research Data

From the findings, the F-statistics reveals that, the independent variable: regulatory provisions can significantly predict the financial performance of the SACCO societies ($F_{1, 56} = 20.497$, $P < 0.05$). Therefore, F value of 20.497 significant at 0.05 confidence level indicated that the independent variable contributed to the variance of in SACCO society's financial performance. The F value also indicates that the simple regression model is statistically significant.

4.5.4 Model Summary

To assess the amount of variation of Financial Performance that could be explained by regulatory provisions, the coefficient of determination was used. Findings are presented in table below.

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.404a	0.341	0.142	2.60327
a Predictors: (Constant), GENO, REP, GOV, PRU				

Source: Research Data

From the findings, the R value which is the coefficient of correlation being 0.404 implying a moderate linear relationship while the coefficient of determination (R-Square) being 0.341. The R-Square value is the coefficient of determination (expressed as a percentage) and shows variability in dependent variable explained by the variability in independent variables. From the model it was found that only 34.1%

of the variation in the financial performance (dependent variable) of the SACCOs in Kenya can be explained by regulatory compliance. This suggests that regulatory compliance to a large extent did not contribute to the level of financial performance in SACCOs.

4.5.5 Coefficients of Determination

The un-standardized regression coefficients, the standardized beta coefficients and t-test values are presented in table below. The un-standardized regression coefficients were used to obtain the regression equation that shows the relationship between regulatory provisions and financial performance of SACCOs in Kenya.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.827	4.231		3.377	0.175
	X1	0.381	0.56	0.359	1.394	0.695
	X2	1.112	0.206	0.182	0.544	0.589
	X3	1.016	0.584	0.204	1.028	0.978
	X4	1.585	1.615	0.145	1.951	0.346
a Dependent Variable: ROA						

Source: Research Data

From the table it is seen that the t-test value for the regression coefficients is significant at 95% confidence level ($p< 0.05$). For this analysis, the regression equation is:

$Y=5.827+0.381X1+1.112X2+1.016X3+1.585x4$

Where

Constant = 5.827, shows that if Governance, Prudential Standards, Reporting Regulations, General Operations = 0, then financial performance would be 5.827.

X1= 0.381, shows that one unit change in governance results in 0.381 units increase in financial performance.

X2= 1.112, shows that one unit change in Prudential Standards results in 1.112 units increase in financial performance.

X3= 1.016, shows that one unit change in Reporting Regulations results in 1.016 units increase in financial performance.

X4= 1.587, shows that one unit change in General Operations results in 1.587 units increase in financial performance.

4.5 Summary and Interpretation of the Findings

4.5.1 Linking with Theory

The Study found that financial regulatory provision of developing loaning policy specifically detailing loan concentration limit has been met and implemented. In theory, Positive theories of regulation examine why regulation occurs. These theories of regulation include theories of market power, stakeholders interest in regulation, and the theories of Government opportunism that describe why restrictions on Government discretion may be necessary for the sector to provide efficient services for customer. Hertog (2007) supported Armstrong’s argument as he agreed with the public interest theory which suggested that Government regulations is a response to public demands for Government to rectify situations of market failure through imperfect competition, market disequilibria, information asymmetry or markets that are undesirable for social reasons.

The study found that governance regulation on the election of the independent board has not improved profitability. In theory, Barth et. al., (2002) raised many arguments in favor of Government intervention in the financial sector. They argued that the existence of monopoly power externalities and information asymmetries create beneficial role for Government interventions to offset market failures and enhance social welfare. They also argued that regulation helps to redistribute wealth away from the institutions to stakeholders even when there are no market failures.

The Study found that financial regulatory provision of developing loaning policy specifically detailing loan concentration limit has been met and implemented. In theory, Armstrong (2005) looked at the development and techniques of regulations and found that regulations occur because; the Government is interested in overcoming information asymmetries with the operator and in aligning the operator's interest with the Government's interest, customers desire protection from market power when competition is ineffective, operators desire protection from rivals, or operators desire protection from Government opportunism.

4.5 2 Linking with Literature

The study found that governance issue is a challenge that SACCOs face in meeting provisions. However, on a study that was done by Wamalwa (2012) concluded that the SACCO performance has greatly improved following the compliance of the Governance rule. The study also found that financial regulatory provision of developing loaning policy specifically detailing loan concentration limit has been implemented. In literature, a study that was done by Ngaira (2011) conclude that operational and financial challenges in implementing the regulations resulting from cost of loans and speed of processing loans the other challenge noted was the liquidity provisions and the control of investment avenues that affected the SACCOs operational capacity and ability to competitively. This is also in agreement with the study which found that lack of enough funds was a challenge in meeting the financial regulatory provisions.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMNDATIONS

5.1 Introduction

This chapter presents the summary of the study, research findings, conclusions and recommendations.

5.2 Summary

The study aimed at assessing the effect of the regulatory compliance on the financial performance in deposit taking SACCOs in the south rift region based on two objectives. The study looked into two objectives. The first was establishing the extent to which Sacco societies in South Rift have implemented these Government's financial regulations. The study found that financial regulatory provision of developing loaning policy specifically detailing loan concentration limit, terms and condition of insider leading has been met on a great extent. It found out that separation of shares from member deposits has also been implemented alongside with auditing and reporting on a monthly, quarterly and annually as per the regulations. The study found out that lack of enough funds, regulation cost, governance issues, management Information Systems are the major challenges that SACCOs face in meeting provisions. The study further found that training; enhanced compliance; procurement of information and mobilizing funds from members are the major strategies used by SACCOs.

The study also found that governance regulation on the election of the independent board has not improved profitability and separation of board and management has affected financial performance. It found out that the effect of the annual audited accounts on the profitability and financial performance of the SACCOs has affected greatly the financial performance of SACCOs. The study found that capital requirements, regulatory requirement of insider trading and external borrowing requirement has affected the financial performance of SACCOs in Kenya. Enforcement action to inspect the SACCOs and general provision of branch opening approval has also affected financial performance of SACCOs.

The second objective of the study was to analyze the relationship between the extents to which these SACCOs have implemented the financial regulations and their level of financial performance. The study established that there was a positive but weak significant relationship between the level of financial performance and the government financial regulations, as only 34.1% of the variations in the financial performance could be explained by the implementation of the government financial regulations.

5.3 Conclusion

On the basis of the findings, the study concluded that regulatory compliance to a little extent had an impact on the financial performance of SACCO societies in the study area. It concluded that financial regulatory provision of developing loaning policy specifically detailing loan concentration limit, separation of shares from member deposits has also been implemented alongside with auditing and reporting on a monthly, quarterly and annually as per the regulations. Even if the provisions have been met, the study concluded that there are challenges like lack of enough funds, regulation cost and governance issues that face SACCOs in meeting the provisions.

The study further concluded that the effect of the annual audited accounts on the profitability and financial performance of the SACCOs has affected greatly the financial performance of SACCOs. It finally concluded that there was a positive but weak significant relationship between the level of financial performance and the government financial regulations

5.4 Recommendations to policy and practice

The findings revealed that financial regulations were implemented to a great extent possibly due to awareness and enhanced supervisory model adopted by SASRA. The management of the SACCO societies should have copies of the SASRA Act and regulations since these are the relevant sources where the financial regulations are found. The management committees and other officials of the cooperative societies should establish management support networks to enable them to obtain new ideas and useful information for the promotion of the sector. This will allow them to compete with other established financial institutions since this was found to be one of the major problems that the sector faces.

The regulators should enhance the regulatory model of CAMEL tool (Evaluating the capital, asset quality, governance, earning, liquidity and going concern since from the study models this has positively enhanced financial performance and assisted in comparing the deposit taking SACCOs with the industry peers by mainstreaming the deposit SACCOs in the financial sector through the use of the tool that is universally applied in the financial sector.

The deposit taking SACCOs also concluded on majority having challenges of the management information systems to help them carry out their operations and meet the regulatory provisions. Human capital and cost of regulation was greatly mentioned to be the challenges facing the deposit taking SACCOs. The government should seek ways of working with the donor partners to assist in capacity building and address the challenges of management information system and the human capital gaps.

5.5 Limitations of Study

The study looked at the effect of regulatory compliance on financial performance of deposit taking SACCOs. The study was limited to South Rift Region of Kenya. The study was limited to the extent of respondent's honesty and biases .this is an inherent risk of collecting the wrong response due to the various biases and fear from the respondents. The study model was also limited in terms of the study variable being financial performance only, other important factors that contribute to the SACCOs growth was not evaluated and thus the r squared of 34.1% meaning there are other indicators that explain 65.9% of financial performance in SACCOs.

5.6 Suggestion for Further Research

The study concentrated on the financial performance indicators, more research need to be carried out on the non-financial indicators that enhance the performance of the deposit taking SACCOs and which have an effect later on the financial performance (Profitability and Growth). The study should be modeled further around the following parameter. Innovation, customer satisfaction, learning and development, improved business processes, culture of the organization and operations management.

Further research need to be done on the effect of the macro economic factors on the financial performance of the SACCOs. The key macro-economic factors to be reviewed are inflation, exchange rate movement and the capital flows from the Diasporas and its effect on performance.

SACCOs mainly depend on external borrowing to provide more credit facilities to its members. Further research needs to be done to establish the effect of external borrowing on financial performance of deposit taking SACCOs, with main parameters being the effect on the cost of the loan to members and effects to the loan given to existing members.

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QUESTIONNAIRE

TOPIC: THE EFFECTS OF REGULATORY COMPLANCE ON FINANCIAL PERFORMANCE OF DEPOSIT TAKING SACCOS, A CASE OF SOUTH RIFT REGION

Introduction: The purpose of this questionnaire is to collate data on the effects of regulatory compliance on financial performance of deposit taking SACCOs in the South Rift region. Once the data is collected the information will be used to inform in the enhancement and development of the regulatory provision and to add to the academic research that exists.

SECTION ONE:

INSTITUTIONAL PROFILE (UNDERSTANDING OF THE ACT AND REGULATIONS

1. Name of the SACCO____

2. How many Years has the SACCO being operating as a FOSA

0-5 ☐ 5-10 ☐ >10 ☐

3. What is the total number of members currently

0-20,000 ☐ 20,000-80,000 ☐ >100,000 ☐

4. What is the sponsoring entity?

Agriculture ☐ Member based ☐ Employer/Organisation ☐

5. What is the current capitalisation level (Millions)?

10-50M ☐ 51-100M ☐ 100-400M ☐ >500M ☐

6. How many branches does the FOSA have_______________________________

SECTION TWO: FINANCIAL REGULATORY PROVISION

Please indicate the extend in which you meet or have implemented the financial prudential provision as outlined below and the deadlines provided as per the legislative clauses by ticking(√)in the appropriate space.**(NS**-No extend **LE** Negligible extent, **N** Neutral, **LN** Large Extent, **VLE** Very Large Extend).

No	Financial Regulatory Provisions	**No Extend**	**Less Extend**	**Neutral**	**Large Extend**	**Very large extend**
1	Separation of shares from member deposits					
2	Maintaining the 15% liquidity assets					
3	Putting in place contingency plan to handle liquidity					
4	Monitoring of liquidity and submission of a monthly statement of liquidity return to the Authority					
5	Not to engaging in prohibited businesses					
6	Not depending on Short term external borrowing					
7	Developing loaning policy specifically detailing loan concentration limit, terms					

	and condition of insider lending					
8	Providing borrowers with quarterly statement of on outstanding credit facility					
9	Seeking prior approval to introduce any new loan Product.					
10	External borrowing, the Sacco shall not borrow more than 25% of its total capital and shall charge interest at least 2% higher than the borrowing rate.					
11	Classification of loan in the following categories; performing, watch, substandard, Doubtful					
12	Financial investment should not exceed 40% of core capital or 5% of total deposits					
13	Providing borrowers with quarterly statement of on outstanding credit facility					
14	Investment in non earning asset should not exceed 10% of the total assets in which land and buildings should not exceed 5% of					

	the total assets.					
15	Auditing and reporting on a monthly, quarterly and annually as per the regulations clauses.					

1. What are the challenges that you are facing so as not to achieve or met the above required provisions.

   ____

   ____

2. What strategies have the SACCO put in place to address the above challenges?

   ____

   ____

   ____

3. What business opportunities have been created by the new regulatory framework?

   ____

   ____

   ____

SECTION THREE: TO ESTABLISH THE EFFECTS OF REGULATORY COMPLANCE ON FINANCIAL PERFORMANCE (THE RELATIONSHIP)

This section is concerned with assessing whether regulations affects financial performance of the SACCOs in the South Rift Region. Please mark (x) in the box which best describe your agreement and disagreement.

No	Regulatory Compliance Requirements	**No Extend**	**Less Extend**	**Neutral**	**Large Extend**	**Very large extend**
Effects of regulatory compliance of Governance on the financial performance						
1	Governance regulation on the election of the					

	independent board has it improved profitability					
2	Have the established committees (Audit, credit and finance Committee).improved financial performance					
3	Has the directive of directors been subjected to fit and proper test improved performance					
4	Separation of board and management .does it have effect of financial performance					
Effects of regulatory compliance of Reporting requirement on the financial performance						
1	Effect of regulation of reporting requirement of monthly capital adequacy ,liquidity, and deposit on financial performance					
2	Introduction of regulation reporting of quarterly risk classification of assets and loan provision of loss and investment returns on the profitability of the SACCO.					
3	Effect of the annual audited accounts on the profitability and financial performance of the SACCO.					
Effects of regulatory compliance of prudential financial requirement on the financial performance						
1	Effects of the capital requirements on the financial performance of the SACCOs					
2	Effect of the external borrowing requirement on the financial performance					
3	Effect of the asset categorization requirement					

	on the financial performance					
4	Effect of the regulatory requirement of insider trading on financial performance					
Effects of regulatory compliance of general operation requirement on the financial performance						
1	Effects of the general provision of branch opening approval on the financial performance of the SACCOs					
2	Effect of the enforcement action to inspect the SACCOs on the financial performance					
3	Effect of not engaging in prohibited business on the financial performance of the SACCOs					

1. Please name other non financial gains from the regulatory compliance requirements

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____

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APPENDICES

APPEDICE 1- LISTING OF DEPOSIT TAKING SACCOS PER COUNTY

Composition and Distribution of Deposit Taking Saccos per County

County	Members	Share. Capital	Deposits	Turnover	Loans/Adv	Total. Assets	Fosa
Mombasa	24,362	62,719,928	3,070,854,857	1,035,212,306	4,822,680,229	5,539,782,690	7
Kwale	7,097,600	319,032,700	36,027,048	167,491,491	323,000,972		1
Kilifi	31,780	40,602,849	1,673,259,608	345,896,319	1,768,625,663	2,311,363,366	3
Tana River	1,073	4,154,880	93,898,792	7,682,055	63,609,368	141,637,224	1
Lamu	5,689	1,315,200	85,404,093	25,610,850	88,288,480	154,360,076	1
Taita /Taveta	2,637	10,980,773	408,670,487	80,034,711	322,599,896	560,330,373	1
Garissa **							
Wajir **							
Mandera **							
Marsabit	916	465,100	158,873,032	20,005,879	123,615,677	207,992,321	1
Isiolo	702.1	1,093,120.00	102,492,831	16,200,508	127,454,116	156,226,357	1
Meru	192,214	588,317,855	4,247,847,367	736,079,220	4,182,524,437	6,734,120,142	14
Tharaka Nithi	14,394	61,533,369	1,102,947,9	213,306,249	1,224,106,9	1,645,022,4	2

			51		24	22	
Embu	138,117	117,730,212	2,140,207,695	457,277,408	1,620,216,638	3,081,575,893	7
Kitui	10,288	27,350,205	1,311,247,404	277,237,965	1,372,251,669	1,797,887,570	2
Machakos	27,018	80,718,880	1,614,233,794	207,293,875	1,545,546,479	2,147,477,397	3
Makueni **							
Nyandarua	12,170	102,674,872	1,459,888,613	270,191,101	1,498,684,303	2,070,945,468	5
Nyeri	179,903	198,697,707	2,878,885,125	637,618,756	2,857,235,621	4,431,081,799	10
Kirinyaga	86,999	364,326,161	1,751,044,273	446,141,822	1,245,931,271	2,708,007,019	6
Muranga	179,023	498,123,897	6,201,527,723	952,077,727	5,605,469,575	8,751,688,422	6
Kiambu	59,533	395,633,231	5,194,677,196	1,952,534,482	5,350,143,903	7,713,568,988	16
Turkana **							
West pokot	3,322	6,551,040	420,244,020	34,548,252	269,100,156	560,908,389	1
Samburu	1,668	14,974,505	219,725,868	41,272,901	297,795,557	381,149,117	2
Trans-nzoia	4,440	33,492,682	393,069,428	72,436,283	383,022,673	584,779,995	2
Uasin Gishu	18,384	143,695,106	1,497,978,316	201,026,599	1,658,426,785	2,309,212,709	5
Elgeyo/Marak	5192	24,940,926	593,703,454	61,981,830	546,824,187	698,371,632	2

wet							
Nandi	11,572	37,938,503	740,002,815	103,442,894	447,662,248	846,606,803	5
Baringo	12,004	264,063,125	1,734,426,475	386,574,679	1,854,565,738	2,821,936,068	2
Laikipia	85,523,058	655,206,871	138,360,115	1,059,022,567	1,330,650,346		2
Nakuru	15,342	79,865,773	2,552,225,371	442,066,786	2,504,623,096	3,407,874,008	5
Narok	3,232	7,063,766	425,316,729	25,593,617	512,177,627	625,283,794	2
Kajiado	2,524	6,197,277	238,210,927	72,477,403	299,127,761	361,382,028	2
Kericho	86,305	343,634,866	4,687,710,936	998,748,137	5,347,701,231	7,418,424,036	7
Bomet	53,560	205,288,931	947,015,154	692,247,482	606,031,791	1,444,474,051	10
Kakamega	107,482	304,305,755	2,826,991,249	743,155,316	3,321,855,180	4,667,514,133	4
Vihiga	7,069	16,571,164	5,776,550	7,277,930	6,145,385	28,568,781	1
Bungoma	10,218	57,526,144	858,509,207	167,279,145	689,509,568	995,346,129	7
Busia	18,254,207	362,908,652	41,690,320	349,782,614	444,444,154		k1
Siaya	1,902	5,166,000	161,772,314	30,719,919	99,696,183	298,689,150	1
Kisumu	13,481	68,066,029	1,053,440,003	134,746,701	1,195,112,525	1,656,298,700	8
Homabay	3,452	14,261,038	194,366,588	16,437,573	209,271,281	286,119,23	4

						9	
Migori	5,381,120	194,831,482	19,770,053	268,384,026	323,770,553		1
Kisii	73,437	201,529,287	3,706,535,749	1,004,076,427	3,936,649,166	5,278,180,349	9
Nyamira	13,567	14,841,878	103,955,950	54,891,888	116,237,543	190,806,811	1
Nairobi	487,706	2,697,311,822	82,262,019,680	11,256,074,794	87,772,291,123	109,043,348,418	45

- Counties with no Deposit Taking Saccos

APPENDICE 2 – STATEMENT OF FINANCIAL POSITION

CONSOLIDATED INCOME AND EXPENDITURE FOR LICENSED SACCOS EXPRESSED AS A % AS AT DECEMBER,2011

Source: SACCO Society Regulatory Authority

INCOME	**2011 K.sh.**	**% of Total Income**	**2010 K.sh.**	**% of Total Income**
Financial Income from Loans Portfolio	18,049,845,464	84.6%	15,793,037,809	83.9%
Income from Investments	628,367,209	2.9%	470,654,003	2.5%
Other Operating Income-Salary processing fees, membership fees etc.	2,669,716,486	12.5%	2,552,690,388	13.6%
Total Income	**21,347,929,159**	**100%**	**18,816,382,199**	**100%**
EXPENSES			0	0
Interest Expense on Deposits	5,887,784,774	28%	4,499,779,691	24%
Cost of External Borrowings	1,895,382,203	9%	1,626,222,161	9%
Dividend Expenses (on member shares)	739,707,191	3%	559,737,625	3%
Fees & Commission Expense	42,162,870	0%	76,747,409	0.40%
Other Financial Expenses	669,659,304	3%	663,926,295	4%
Total Expenses	9,234,696,342	43%	7,468,983,155	39%
Net Financial Income	**12,113,232,817**	**57%**	**11,347,399,044**	**61%**

Name of Saccos and Branches

NAME	BRANCHES
SOT TEA	6
NDEGE CHAI	1
SOT TEA	6
SOT TEA	6
BURETI	2
KONOIN	1
NAROK TENDER	2
SIMBA	1
EGERTON	1
TENHOS	1
SOTICO	1
HIGHLANDS	2
SIMBA	1
COSMOPOLITAN	1
IMARISHA	4